Summary of Testimony of
Cynthia A. Marlette
General Counsel
Federal Energy Regulatory Commission
Before the Committee on Energy and Natural Resources
United States Senate
February 6, 2002

At this critical stage in the evolution of the electric industry, it is important to take all reasonable measures to support the development of competitive energy markets and to provide appropriate incentives for electric and natural gas infrastructure to meet our nation's energy needs. Legislative reform, including repeal or reform of the Public Utility Holding Company Act (PUHCA), would help to more rapidly accomplish the goal of wholesale power competition which the Congress endorsed a decade ago in the Energy Policy Act of 1992. However, any legislative reform must ensure adequate protection of electric and natural gas ratepayers from abuse of market power and inappropriate affiliate cross-subsidization.

PUHCA, as it currently exists, may actually impede competitive markets and appropriate competitive market structures. In particular, it encourages greater geographic concentrations of generation ownership, which may increase market power. Further, it may cause unnecessary regulatory burdens for utilities who seek to form or join regional transmission organizations (RTOs) and could serve as a significant disincentive for investments in independent for-profit transmission companies that qualify as RTOs or that operate under an RTO umbrella.

PUHCA should be repealed or reformed, so long as the following matters are addressed. First, Congress should ensure that the Federal Energy Regulatory Commission (FERC) and state regulatory authorities have adequate access to the books and records of all members of all public utility holding company systems when that information is relevant to their statutory ratemaking responsibilities. Second, any exemptions from a new holding company act should be crafted narrowly. While it may be appropriate to grandfather previously authorized activities or transactions, no holding company should be exempt from affiliate abuse or market power oversight.

The PUHCA repeal provision of S. 1766, as introduced on December 5, 2001, in conjunction with other provisions in the bill would, from the FERC regulatory standpoint, help remove remaining competitive barriers and provide additional regulatory tools to sustain competitive wholesale power markets and protect wholesale customers. If PUHCA is not repealed, the Congress needs to close the current regulatory gap created by a 1992 court decision interpreting PUHCA, which impairs the FERC's ability to protect customers of registered holding companies from affiliate cross-subsidization.

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Mr. Chairman and Members of the Committee:

Good morning. My name is Cynthia A. Marlette, and I am General Counsel of the Federal Energy Regulatory Commission (FERC or Commission). Thank you for the opportunity to appear here today to discuss the effects of repealing the Public Utility Holding Company Act of 1935 (PUHCA) and whether, if PUHCA is repealed, the provisions of S.1766 are sufficient to ensure competitive energy markets and provide adequate customer protection. I appear today as a Commission staff witness and do not speak on behalf of the Commission or any Commissioner.

In light of the Commission's primary statutory mission and expertise in regulating interstate transmission and rates charged in wholesale energy markets, my comments today focus on wholesale customer (ratepayer) protection. They do not address whether any provisions of PUHCA or other legislative measures are necessary to protect the interests of shareholders or employees of electric or gas holding companies or their subsidiaries or affiliates. I defer to other agencies with greater expertise on these important issues.

At this critical stage in the evolution of the nation's electric industry, it is important to take all reasonable measures to support the development of competitive energy markets and to provide appropriate incentives for electric and natural gas infrastructure to meet our nation's energy needs. Legislative reform, including repeal or reform of PUHCA, would help to more rapidly accomplish the goal of wholesale power competition which the Congress endorsed a decade ago in the Energy Policy Act of 1992. As I will discuss further in my testimony, the PUHCA repeal provisions of S.1766 in conjunction with other provisions in the bill would, from the FERC's regulatory standpoint, help remove remaining competitive barriers, provide additional regulatory tools to sustain competitive wholesale power markets, and ensure adequate protection of electric and natural gas ratepayers from abuse of market power and inappropriate cross-subsidization.

We are now at a pivotal juncture in the development of competitive power markets, and it is appropriate for the Congress to reexamine the framework for regulating electric utilities, including unnecessary restrictions that PUHCA places on the activities of certain participants in these power markets. Although PUHCA was enacted to protect against corporate structures that could harm investors and ratepayers, today some of PUHCA's restrictions may actually impede competitive markets and appropriate competitive market structures, harming ratepayers and shareholders in the long run.

Since the legislative debate on PUHCA repeal began before the Congress almost six years ago, two major events have caused policy makers to more carefully examine PUHCA repeal and the adequacy of regulatory tools and protections under existing law and under various pending legislative proposals. These events are the California energy crisis and the recent collapse of Enron with its devastating effects on shareholders and employees. Both events have heightened scrutiny of competitive markets and the appropriate regulatory framework for the future of the electric industry. However, the majority of industry observers, including the Commission, continue to support competitive power markets, rather than traditional cost-based regulation, as the best means of serving energy customers in the long run.

In past testimony, FERC witnesses have raised no objection to repeal or reform of PUHCA, so long as certain ratepayer issues are addressed. Today, we continue to take the position that PUHCA needs to be repealed or reformed, so long as the following matters are addressed:

- First, Congress should ensure that the FERC and state regulatory authorities have adequate access to the books and records of all members of all public utility holding company systems when that information is relevant to their statutory ratemaking responsibilities. This is necessary to prevent affiliate abuse and subsidization by electricity and natural gas ratepayers of the non-regulated activities of holding companies and their affiliates.
- Second, any exemptions from a new holding company act should be crafted narrowly. While it may be appropriate to grandfather previously authorized activities or transactions, no holding company should be exempt from market power and affiliate abuse oversight.
- Third, if Congress retains any existing PUHCA functions and transfers them from the SEC to the FERC, instead of repealing PUHCA in its entirety and replacing it with broader access to books and records, Congress needs to

provide FERC with staff and administrative support necessary for us to carry out the additional responsibilities.

Title II of S. 1766, as introduced on December 5, 2001, adequately addresses the above substantive concerns with respect to PUHCA reform. Title II of S. 1776 also provides additional regulatory tools to help promote a competitive marketplace for electric energy and protect wholesale customers. We believe these new provisions would significantly enhance the Commission's current authority under the Federal Power Act (FPA) to create and sustain competitive power markets and ensure customer protection. The one matter that is not addressed in S. 1766, and which would help promote a competitive marketplace and avoid potentially lengthy litigation, is a clarification of the Commission's authority to require regional transmission organizations (RTOs) where it finds RTOs to be in the public interest. RTOs will broaden regional energy markets, allow greater market efficiencies and eliminate remaining discrimination in transmission access and grid operations.

Background

Under current law, the two major federal statutes affecting electric utilities are PUHCA and the FPA. Both statutes were enacted as part of the same legislation in 1935 to curb widespread financial abuses that harmed electric utility investors and electricity customers. While there is overlap in the matters addressed by these Acts, they each have different public interest objectives. The areas of overlap in the two statutes, and specific issues raised if PUHCA is repealed or amended, are described in detail in the Attachment to this testimony. As a general matter, however, the Securities and Exchange Commission

(SEC) regulates registered public utility holding companies under PUHCA while FERC regulates the operating electric public utility and gas pipeline subsidiaries of the registered holding companies under the FPA and Natural Gas Act (NGA). The agencies often have responsibility to evaluate the same general matters, but from the perspective of different members of the holding company system and for different purposes. The FERC focuses primarily on a transaction's effect on utility ratepayers. The SEC focuses primarily on a transaction's effect on corporate structure and investors.

In June 1995, the SEC issued a report entitled “The Regulation of Public-Utility Holding Companies” and recommended that Congress conditionally repeal PUHCA and enact certain ratepayer safeguards in its place. We agree with a fundamental premise of the SEC’s report that rate regulation at the federal and state levels has become the primary means of ensuring ratepayer protection against potential abuse of monopoly power by utilities that are part of holding company systems.

We also believe that PUHCA, in its current form, may actually encourage market structures that impede competition. In particular, under PUHCA acquisitions by registered holding companies generally must tend toward the development of an "integrated public-utility system." To meet this requirement, the holding company's system must be "physically interconnected or capable of physical interconnection" and "confined in its operations to a single area or region." This requirement tends to create greater geographic concentrations of generation ownership, which may increase market power and diminish electric competition.

In addition, PUHCA may cause unnecessary regulatory burdens for utilities who, in compliance with Commission policy and regulations, seek to form or join RTOs. RTOs will provide the major structural reform needed in the electric industry to mitigate market power and operate an efficient, reliable transmission system. These institutions will operate, or both own and operate, the interstate transmission grid within their regions, provide transmission services on an open, non-discriminatory basis, and perform regional transmission planning. They may be non-profit independent system operators (ISOs), or they may be for-profit transmission companies (transcos), or a combination of the two. The cornerstone requirement for the institutions, however, is that they be independent from power market participants, i.e., independent from those that own, sell or broker generation. Under PUHCA, any entity that owns or controls facilities used for the transmission of electric energy -- such as an RTO -- falls within the definition of public utility company, and any owner of ten percent or more of such a company would be a holding company and potentially could be required to become a registered holding company. This could serve as a significant disincentive for investments in independent for-profit transcos that qualify as RTOs or that operate under an RTO umbrella.

Review of S. 1766 Title II Electricity Provisions

S. 1766 PUHCA Amendments

Title II, Subtitle B, of S. 1766 would repeal PUHCA and, in its place, enact the Public Utility Holding Company Act of 2002. The new Act would do five major things:

- provide the FERC with access to books and records of holding companies and their associate and subsidiary companies, and of any affiliates of holding companies or their subsidiaries (section 224);
- give state commissions that have jurisdiction over a public utility company in a public utility holding company system access to books and records of a holding company, its associates or affiliates (section 225);
- require the FERC to promulgate a final rule, no later than 90 days after enactment, to exempt from the books and records access requirements of section 224 any person that is a holding company solely with respect to one or more: qualifying facilities under the Public Utility Regulatory Policies Act of 1978; exempt wholesale generators; or foreign utility companies (section 226);
- provide that nothing in the Act precludes the FERC or a state commission from exercising its jurisdiction under otherwise applicable law to determine whether a public utility or natural gas company may recover in rates any costs of an activity performed by an associate company, or any costs of goods or services acquired from an associate company (section 227); and

- grandfather activities in which a person is legally engaged or authorized to engage on the effective date of the new act (section 231).

With these protections in place, and with the Commission's other regulatory authorities under the FPA in place, we do not believe that the S.1766 PUHCA provisions would impair or diminish protection of wholesale ratepayers.

If PUHCA is not repealed, however, Congress should address what has come to be called the Ohio Power regulatory gap, which was created by a 1992 court decision and which is discussed in greater detail in the Attachment to this testimony. Briefly, in a decision by the United States Court of Appeals for the District of Columbia Circuit, Ohio Power Company v. United States, 954 F.2d 779 (D.C. Cir. 1992), the court held that if a public utility subsidiary of a registered holding company enters into a service, sales or construction contract with an affiliate company, the costs incurred under that affiliate contract cannot be reviewed by FERC. The court reasoned that because the SEC has to approve the contract before it is entered into, FERC cannot examine the reasonableness or prudence of the costs incurred under that contract. FERC must allow the costs to be recovered in wholesale electric rates, even if the utility could have obtained comparable goods or services at a lower price from a non-affiliate.

The Ohio Power decision has left a gap in rate regulation of electric utilities. The result is that utility customers served by registered holding companies under PUHCA have less rate protection than customers served by non-registered systems. If PUHCA is repealed, as in S. 1776, this problem will be solved. If the contract approval provisions of

PUHCA are retained, however, this regulatory gap should be closed to restore FERC's ability to regulate the rates of utilities that are members of registered holding company systems.

S. 1766 Federal Power Act Amendments

In addition to the PUHCA repeal provisions in Subtitle B of S.1766, Subtitle A of S.1766 contains several amendments to Part II of the FPA:

Electric Utility Merger Authority (Section 202 of Subtitle A). Commission authority over mergers and other corporate dispositions under FPA section 203 would be clarified or expanded to include authority over: an electric public utility's purchase, lease or other acquisition of existing facilities for the generation of electric energy or for the production or transportation of natural gas; a merger of a holding company whose holding company system includes a transmitting utility or an electric utility company with another holding company whose holding company system includes a transmitting utility, electric utility company or gas utility company; and any merger, sale, lease or disposition of generation-only facilities. In addition, the value of facilities covered by FPA section 203 would be increased from $50,000 to $1 million before Commission review would be triggered.

Thus, while overlapping SEC-FERC merger review would be eliminated by the repeal of PUHCA, the Commission's review authority would be clarified or strengthened under the new S.1766 provisions. This would provide effective Federal oversight over corporate structures that include FPA public utilities, and the effect of such structures on wholesale competition and rates.

Market-based Rate Authority (Section 203 of Subtitle A). In making a determination of whether market-based rates are just and reasonable and not unduly discriminatory or preferential, the Commission would be required to consider whether: the seller and its affiliates have adequately mitigated market power; whether the sale is made in a competitive market; whether market mechanisms such as power exchanges and bid auctions function adequately; the effect of demand response mechanisms; the effect of mechanisms or requirements to ensure adequate reserve margins; and such other considerations as the Commission may deem appropriate. Further, if the Commission finds under section 206 of the FPA that a market-based rate is not just and reasonable, it would determine the just and reasonable rate and order such other action as would in the judgment of the Commission adequately ensure a just and reasonable market-based rate.

While this provision directs the Commission to consider matters which it already has authority to consider under the existing FPA, it would appear to give the Commission significant new authority to order whatever remedies are necessary ("such other action") to ensure reasonable rates, once the Commission has completed its rate investigation.

Refund Effective Date (Section 204 of Subtitle A). The refund effective date under an FPA section 206 investigation could be as early as the date a complaint is filed or the date the Commission issues a notice of intention to initiate an investigation. This would provide greater refund protection for customers and a stronger deterrence against overpricing by generators.

Transmission Interconnections (Section 205 of Subtitle A). The Commission would be directed to establish, by rule, technical standards and procedures for interconnection. Transmitting utilities that are not regulated as public utilities (e.g., governmental and most electric power cooperative entities) would be required to interconnect upon application by a power producer or on the Commission's own motion.

This provision would strengthen the existing FPA section 210 interconnection authority of the Commission. It also would reduce procedural costs for new generators and transmitting utilities alike and lower overall electricity costs by helping efficient new generators get interconnected to the transmission grid more quickly.

Open Access by Unregulated Transmitting Utilities (Section 206 of Subtitle A) The Commission would have authority to require open access transmission services by unregulated (governmental and most rural electric power cooperative) transmitting utilities at rates comparable to what they charge themselves and terms and conditions comparable to what public utilities must offer. The Commission would be required to exempt small entities, entities that do not own or operate transmission facilities necessary for operating an interconnected transmission system, or entities that meet other criteria that the Commission determines to be in the public interest. The Commission would have authority to remand rates to an unregulated transmitting utility.

This provision would help eliminate a major barrier to creating a seamless national power grid, by allowing the Commission to require open access over the approximate one-third of the transmission grid which currently is beyond the Commission's open access authority under sections 205 and 206 of the FPA. At the same time, the provision recognizes the unique circumstances of governmental and rural cooperative utilities and allows flexibility (e.g., remand of rates that are not just and reasonable) in asserting narrow transmission jurisdiction. This measure should produce transmission cost savings for many customers by reducing or eliminating pancaked transmission rates and discriminatory terms and conditions of transmission service and interconnection.

Electric Reliability Standards (Section 207 of Subtitle A). The Commission would be required to establish and enforce one or more systems of mandatory electric reliability standards. It could certify one or more self-regulatory reliability organizations which may include the North American Electric Reliability Council, one or more regulated reliability councils, one or more RTOs, or any similar organization to monitor and enforce compliance. This would benefit customers by ensuring that there is Federal public interest oversight over electric industry reliability activities, and creating the ability to mandate compliance with what are now voluntary standards.

Market Transparency Rules (Section 208 of Subtitle A). The Commission would be required to issue rules establishing an electronic information system to provide information, on a timely basis, about the availability and price of wholesale electric energy and transmission services to the Commission, state commissions, buyers and sellers of wholesale electric energy, users of transmission and the public. The Commission would require each RTO to provide statistical information about available capacity and capacity constraints on the transmission facilities operated by the RTO and also would require each broker, exchange or other market-making entity to provide statistical information about the amount and sale price of sales it transacts of electric energy at wholesale in interstate commerce. This information would have to be posted on the Internet. The Commission would be required to exempt from disclosure commercial or financial information that it determines to be privileged, confidential or otherwise sensitive.

These provisions would help prevent potential litigation about the Commission's ability to require market information disclosure where appropriate. They would improve market transparency through better electronic dissemination of information about trades in the energy markets and the transfer capabilities of the transmission infrastructure. The measures would help the Commission establish sound competitive wholesale markets by validating and broadening the agency's authority to compel such reporting and information dissemination. They also would help the Commission and financial market regulators and players to better monitor individual companies' participation and diminish the ability of any individual player to misbehave or misrepresent in the marketplace. There are two cautions, however:

First, while the S.1766 provisions address actual trades, they do not appear to address at least two of the issues at the heart of Enron's situation - - how the Enron companies handled and reported the risks and valuation underlying the trades they were conducting, and how they represented the value of the trades flowing through their platforms as corporate revenue. Those are broader financial reporting and regulation issues that are outside the scope of the Commission's jurisdiction and expertise.

Second, there is a difficult balance to be struck between information that must be disclosed to make markets work and information that is commercially proprietary. It is clearly to the public benefit to implement rules that disclose more information and improve market transparency, but it is not always easy in practice to find the appropriate point between reasonable information disclosure and protection. S.1766's requirement to exempt commercial or financial information that the Commission determines is privileged, confidential or otherwise sensitive appears to give the Commission sufficient discretion on this important matter.

Access to Transmission by Intermittent Generators (Section 209 of Subtitle A). The Commission would be required to ensure that all transmitting utilities provide transmission service to intermittent generators in a manner that does not penalize such generators for characteristics that are inherent to intermittent energy resources and are beyond the control of such generators.

These provisions would allow more renewable energy to be integrated into market operations at lower operating costs. This would enhance customers' ability to choose more environmentally clean energy sources.

Enforcement (Section 210 of Subtitle A). The entities that could file a complaint under the FPA would be expanded to include electric utilities, and the entities against whom a complaint could be filed would be expanded to include transmitting utilities. Similarly, the Commission would have authority to investigate whether transmitting utilities have violated the FPA. The Commission's civil penalty authority under FPA section 316A ($10,0000 per day per violation) would be extended to cover any violation under Part II of the FPA.

The Commission currently has very limited civil penalty authority under section 316A of the FPA. This provision would significantly expand the Commission's ability to enforce Part II of the Act which would in turn enhance the Commission's ability to bring the benefits of competitive electric markets to customers.

S. 1766 PURPA Amendments

Subtitle C of S.1766 would amend some of the provisions currently under the FERC's jurisdiction under the Public Utility Regulatory Policies Act of 1978:

Termination of Mandatory Purchase and Sale Requirements (Section 244 of Subtitle C.) The mandatory purchase and sale requirements of PURPA (between qualifying facilities (QFs) and electric utilities) would be terminated; contracts existing on date of enactment would be grandfathered; and statutory ownership limitations for qualifying facilities would be eliminated.

These provisions would eliminate statutory requirements which are inconsistent with today's competitive power markets but, at the same time, would not disrupt expectations associated with pre-existing contracts.

Net Metering (Section 245 of Subtitle C). Electric utilities would be required to make net metering service available upon request to an electric customer that the electric utility serves. The Commission would be permitted to adopt by rule control and testing requirements for on-site generating facilities and net metering systems, in addition to the other requirements in the statute, if the Commission determines they are necessary to protect public safety and system reliability.

Conclusion

Legislative reform, including repeal or reform of PUHCA, would help to more rapidly accomplish the goal of wholesale power competition. However, any repeal of PUHCA must ensure adequate protection of ratepayers, including state and federal regulator access to books and records of holding company members. The PUHCA repeal provisions of S. 1766 in conjunction with other provisions of the bill would, from the FERC's regulatory standpoint, help remove remaining competitive barriers and provide additional regulatory tools to sustain competitive wholesale power markets and protect wholesale and retail customers.

Thank you again for the opportunity to be here today. I would be happy to answer any questions you may have.

ATTACHMENT
TESTIMONY OF CYNTHIA A. MARLETTE
FEBRUARY 6, 2002

Existing Statutory Framework: FERC/SEC Jurisdiction

The FERC's primary function under the FPA is ratepayer protection. The FERC regulates public utilities as defined in the FPA. These include individuals and corporations that own or operate facilities used for wholesale sales of electric energy in interstate commerce, or for transmission of electric energy in interstate commerce. The FERC does not regulate all utilities. For example, publicly-owned utilities and most cooperatives are exempt from our traditional rate regulatory authority.

The FERC ensures that rates, terms and conditions for wholesale sales of electric energy and transmission are just, reasonable and not unduly discriminatory or preferential. In addition, the FERC has responsibilities over corporate mergers and other acquisitions and dispositions of jurisdictional facilities, transmission access, certain issuances of securities, interlocking directorates, and accounting. In exercising its responsibilities, the Commission must take into account any anticompetitive effects of jurisdictional activities.

There is overlap in the jurisdiction of the FERC and the SEC. As a general matter, the SEC regulates registered utility holding companies whereas the FERC regulates the operating electric utility and gas pipeline subsidiaries of the registered holding companies. The agencies often have responsibility to evaluate the same general matter, but from the perspective of different members of the holding company system and for different purposes. The FERC primarily focuses on the impact of a transaction on utility ratepayers. The SEC, on the other hand, primarily focuses on the impact of a transaction on corporate structure and investors.

There are four major areas of overlap in the jurisdiction of the FERC and the SEC with respect to regulation of the electric industry:

(1) Accounting - The SEC has authority to establish accounting requirements for every registered holding company, and every affiliate and subsidiary of a registered holding company. Many of these companies are public utilities that are also under the FERC's jurisdiction and subject to its accounting requirements.

(2) Corporate regulation - The SEC must approve the acquisition of a public utility's securities by a registered holding company. The FERC must approve the disposition or acquisition of jurisdictional facilities by a public utility.

(3) Rates - The SEC must approve service, sales and construction contracts among members of a registered holding company system. The FERC must approve wholesale rates reflecting the reasonable costs incurred by a public utility under such contracts.

(4) PUHCA Exemptions - Under the PUHCA section 32 amendment contained in the Energy Policy Act of 1992, the FERC must determine whether an applicant meets the definition of exempt wholesale generator, and thus is exempt from the Holding Company Act. With minor exceptions, the SEC continues to make PUHCA exemption determinations under the pre-Energy Policy Act PUHCA provisions as well as under the new section 33 of PUHCA (concerning foreign utility companies).

Congress recognized the overlap in FERC-SEC jurisdiction when it simultaneously enacted PUHCA and the FPA in 1935. It included section 318 in the FPA, which provides that if any person is subject to both a requirement of the FPA and PUHCA with respect to certain subject matters, only the requirement of PUHCA will apply to such person, unless the SEC has exempted such person from the requirements of PUHCA. If the SEC has exempted the person from the PUHCA requirement, then the FPA will apply.

During the half-century following enactment of PUHCA and the FPA, there were no significant problems resulting from the overlap in FERC-SEC jurisdiction, until a series of court decisions involving the wholesale rates of the Ohio Power Company. Under the last of these court decisions, a 1992 decision by the United States Court of Appeals for the District of Columbia Circuit (Ohio Power Company v. FERC, 954 F.2d 779 (D.C. Cir. 1992) (Ohio Power)), the FERC does not have the extent of rate jurisdiction which it previously thought it had over public utility subsidiaries of registered electric utility holding companies.

Under the 1992 Ohio Power decision, if a public utility subsidiary of a registered holding company enters into a service, sales or construction contract with an affiliate company, the costs incurred under that affiliate contract cannot be reviewed by the FERC. The SEC has to approve the contract before it is entered into. However, the FERC cannot examine the reasonableness or prudence of the costs incurred under that contract. The FERC must allow those costs to be recovered in wholesale electric rates, even if the utility could have obtained comparable goods or services at a lower price from a non-affiliate.

This decision has left a major gap in rate regulation of electric utilities. The result is that utility customers served by registered holding companies have less rate protection than customers served by non-registered systems. If PUHCA is repealed, the Ohio Power problem goes away. This is a significant advantage of S. 1766, introduced December 5, 2001. S. 1766 would repeal PUHCA and enact a new, more limited law that does not give rise to an Ohio Power problem. Short of repeal of PUHCA, however, the existing regulatory gap needs to be addressed.

Issues Raised If PUHCA Is Repealed or Amended

There are several ratepayer protection issues on which Congress should focus in considering PUHCA legislation. S. 1766 adequately addresses these issues.

An important aspect of ratepayer protection is preventing affiliate abuse and the subsidization by ratepayers of the non-regulated activities of non-utility affiliates. These issues can arise in virtually every area of the FERC's responsibilities. In the case of public utilities that are members of holding companies, there are increased opportunities for abuses. There are several reasons for this.

First, registered holding companies have centralized service companies that provide a variety of services (e.g., accounting, legal, administrative and management services) to both the regulated public utility operating companies in the holding company system, and to the non-regulated companies in the holding company system. The FERC's concern in protecting ratepayers is that when the costs of these service companies are allocated among all members of the holding company system, the ratepayers of the public utility members bear their fair share of the costs and no more; ratepayers should not subsidize the non-regulated affiliates of the public utilities.

Thus far, FERC has had few, if any, problems with inappropriate allocations of service company costs. The services provided by the centralized service companies have been relatively limited. In recent years, however, there has been a substantial increase in the services being performed by these types of service company affiliates. In many registered company systems, the majority of the costs of operating and maintaining the operating utilities' systems, which previously were incurred directly by each individual utility, are now being incurred by the service company and billed to the public utility under SEC-approved allocation methods. These costs can be significant for ratepayers. This means that rate regulatory oversight of service company allocations is imperative.

A second concern involves special purposes subsidiaries. In addition to the centralized service companies, registered holding companies increasingly are forming special purpose subsidiaries that contract with their public utility affiliates to supply services, as well as goods and construction. This can include fuel procurement, services such as operation of power plants, telecommunications, and construction of transmission lines and generating plants.

The FERC's primary concern with affiliate contracts for goods and services is that utilities not be allowed to flow through to electric ratepayers the costs incurred under affiliate contracts if those costs are more than the utility would have incurred had it obtained goods or services from a non-affiliate. As discussed earlier, under the 1935 PUHCA the FERC cannot provide adequate protection to ratepayers served by registered systems because of the 1992 Ohio Power court decision.

The Commission recently has made some progress in protecting customers served by registered holding companies by using its conditioning authority over registered holding company public utilities that seek approval to sell power at market-based rates. The Commission has said that if such utilities want to sell at market-based rates, they must agree not to purchase non-power goods and services from an affiliate at an above-market price; they must agree that if they sell non-power goods and services to an affiliate, they will do so at the higher of their cost or a market price. However, the Commission's market rate conditioning authority is not enough to protect all registered system ratepayers against abusive affiliate contracts. Short of repeal of PUHCA, legislation is needed to fully remedy the regulatory gap.

According to the SEC's 1995 report, service companies render over 100 different types of services to the operating utilities on their systems, with non-fuel transactions aggregating approximately $4 billion annually. This growth adds to the potential for ratepayer subsidies involving both the centralized and the special-purpose service companies.

Another reason for heightened concern regarding affiliate abuses in all holding company systems, both registered and exempt, is the large number of holding company subsidiaries that engage in non-utility businesses. According to the SEC 1995 report, since the early 1980's the number of non-utility subsidiaries of registered companies had quadrupled to over 200. The trend in exempt companies is also likely to be significant as well. The sheer number of non-utility business activities brings greater potential for improper allocation of centralized service company costs to the non-utility businesses (i.e., electric ratepayers subsidizing the non-utilities' fair share of the costs). It also increases the opportunities for affiliate contracting abuses.

To protect against affiliate abuse and cross-subsidization, federal and state regulators must have access to the books, records and accounts of public utilities and their affiliates. Under section 301 of the FPA (and section 8 of the Natural Gas Act), the FERC has substantial authority to obtain such access. It can obtain the books and records of any person who controls a public utility, and of any other company controlled by such person, insofar as they relate to transactions with or the business of the public utility. This, however, may not necessarily reach every member of the holding company. Thus far, there has been no significant problem in obtaining access to books and records and in monitoring and protecting against potential abuses. However, the SEC's regulatory role with respect to registered systems has been an added safeguard.

It is critical that both state and federal regulators have access to books and records of all companies in a holding company system that are relevant to costs incurred by an affiliated utility. This is equally true with respect to both registered and exempted holding company systems. If Congress modifies or repeals PUHCA, it should clearly confirm the FERC's mandate and authority to ensure that ratepayers are protected from affiliate abuse. Similarly, we encourage Congress to be mindful of concerns expressed by state commissions and provide states with appropriate access to relevant books and records of all holding company systems.

In addition to the above ratepayer protection concerns, there are several other matters that should be considered in analyzing PUHCA reform. These include future corporate structures in the electric industry, diversification activities, and the issuances of securities affecting public utilities.

As mentioned earlier, the FERC must approve public utility mergers, acquisitions, and dispositions of jurisdictional facilities. This is an area in which the Commission has overlapping jurisdiction with the SEC, but also an area in which in some instances there is no overlap. Jurisdictional facilities under the FPA are facilities used for transmission in interstate commerce, or for sales for resale in interstate commerce. FERC has claimed jurisdiction over transfers of jurisdictional sales contracts but has disclaimed jurisdiction over dispositions that solely involve physical generation facilities. It appears that most state regulators have authority to regulate dispositions of physical generation assets. Further, such dispositions or acquisitions would be subject to the antitrust laws.

The FERC does not have any explicit jurisdiction to approve or disapprove diversification activities of public utilities or holding companies. Thus, if PUHCA were repealed, the only federal oversight of diversification activities of holding companies or their public utility members would be through FERC auditing of books and records. However, the SEC does not directly review public utility diversification activities of other holding companies and public utilities, and this has not posed any significant problems in the FERC's protection of ratepayers. In addition, many state commissions regulate diversification by public utilities that sell at retail.

A final area involves issuances of securities. The FERC must approve issuances of securities by public utilities that are not members of registered holding company systems, unless their security issuances are regulated by a state commission. Because the majority of states regulate issuances by public utilities, the FERC does not regulate most public utilities' issuances. If PUHCA were repealed, it appears that there would be no federal review and approval of issuances of securities by holding companies or their public utility members. The SEC can more appropriately address whether any federal oversight is necessary in this area.